**#2602** **signed 5-28-03**

**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE DISTRICT OF KANSAS**

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| **In Re:** | |
| **MARCELINO EMELIO RAMIREZ,**<br>**TONI LEE RAMIREZ,** | **CASE NO. 01-42119-13**<br>**CHAPTER 13** |
| **DEBTORS.** | |
| **MARCELINO EMELIO RAMIREZ,**<br>**TONI LEE RAMIREZ,** | |
| **PLAINTIFFS,** | |
| **v.** | **ADV. NO. 01-7122** |
| **HOUSEHOLD FINANCE CORP. III,** | |
| **DEFENDANT.** | |
| **In Re:** | |
| **PATRICIA JOAN MERRIMAN,** | **CASE NO. 01-42851-13**<br>**CHAPTER 13** |
| **DEBTOR.** | |
| **PATRICIA JOAN MERRIMAN,,** | |
| **PLAINTIFF,** | |
| **v.** | **ADV. NO. 01-7142** |
| **BENEFICIAL MORTGAGE CO. OF**<br>**KANSAS, INC.,** | |
| **DEFENDANT.** | |

## ORDER GRANTING SUMMARY JUDGMENTS

These proceedings are before the Court on the debtor-plaintiffs' motions for summary judgment. The debtors are trying to rescind consumer credit home mortgage transactions they entered into with the creditor-defendants. The debtor-plaintiffs appear by counsel Fred W. Schwinn of Livermore, California. The creditor-defendants appear by counsel Todd W. Ruskamp of Kansas City, Missouri. The Court has reviewed the relevant pleadings, and the applicable statutes and case law, and is now ready to rule.

## FACTS

There are no material facts in dispute.

### The Ramirez Transaction

Mr. Ramirez borrowed money from Household Finance Corporation III ("Household") in February 2000. He alone signed a promissory note for $113,061.94. Both he and Mrs. Ramirez signed a mortgage on their principal dwelling to secure the note. Under the federal Truth in Lending Act ("TILA"),[1] Household was required to give both the Ramirezes certain disclosures concerning the loan and a notice informing them of their right to rescind the transaction. Household concedes that it did not give Mrs. Ramirez either the disclosures or the notice and that the Ramirezes were entitled to try to rescind the transaction,[2] as they did by sending a timely notice to Household about one month after they filed a joint Chapter 13 bankruptcy petition. Nevertheless, Household has briefed the question of the sufficiency of the notice of the right to rescind that it gave to Mr. Ramirez. Except for slight

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[1]*See* 15 U.S.C.A. §1601, *et seq*.

[2]*See* 12 C.F.R. §226.17(d) (2003).

variations in the size and style of typeface, Household's notice is identical to the one used by the creditor in the Merriman case, so to the extent it matters, the Court's ruling about Household's notice would be the same as its ruling about the Merriman notice.

More than a month after the Ramirezes sent their notice of rescission, Household's attorney responded by sending a letter to their attorney agreeing it appeared that Household had not provided all the necessary disclosures before the loan was consummated. The attorney stated that Household was "prepared to move forward with the rescission." He asked for certain information from the Ramirezes, and asked their attorney to talk to them about when they would be in a position to refund the net loan proceeds to Household.

**The Merriman Transaction**

Before the transaction giving rise to this litigation, Ms. Merriman had a loan with Beneficial Kansas Inc. ("BKI") that was secured by personal property. In August 2000, she obtained a loan from Beneficial Mortgage Company of Kansas, Inc. ("Beneficial"), for $30,359.45 that was secured by a mortgage on her home. No evidence of an assignment has been provided to the Court, but Beneficial asserts that it was the holder of the loan secured by personal property when Ms. Merriman obtained the loan secured by her home. In any event, some of the proceeds of the mortgage loan were applied to pay off the personal property loan.

In connection with the mortgage loan, Beneficial gave Ms. Merriman the appropriate loan information disclosures required by the TILA, and gave her at least one copy of a form called a "Notice of Right to Cancel" ("Notice"). She concedes that she was given one copy of the Notice, but contends she was given only one. She has signed an affidavit swearing that Beneficial gave her all the documents for the transaction in a folder, that she kept the folder in a special desk drawer where she keeps important papers, that she looked at the documents twice over about fourteen months but never failed to return any of them to the folder, and that the folder contained only one copy of the Notice. An employee of Beneficial swears that she gave Ms. Merriman two copies, as she had been trained to do, and a loan checklist that she used in making the loan indicates that three copies of the Notice were produced, one for Beneficial and two for the customer, Ms. Merriman.

The Board of Governors of the Federal Reserve System ("the Fed"), the agency charged with administering the TILA,[3] has created two model forms that creditors can use to give borrowers notice of their right to rescind a home mortgage transaction, one to use for a loan where the borrower has no outstanding loan with the same creditor ("New Loan Form"), and the other to use for a loan that includes a refinancing of an outstanding loan with the same creditor that is already secured by the borrower's home ("Refinancing Form").[4] Rather than using these separate Forms, though, Beneficial chose to create a single form that contains alternative paragraphs using language similar to that adopted in each of the Fed's Forms, with a spot (created by an underscore surrounded by parentheses) by each that is to be marked or checked to indicate which paragraph applies to the transaction. On the copy contained in Beneficial's files, the designated spot beside the notice for a new loan is checked, and Ms. Merriman has signed at the bottom to certify that she "received this Notice in duplicate." A second page (perhaps the back) of the form has a hand-written date added, and Ms. Merriman has signed it to certify that: (1) three or more days had elapsed since she "received in duplicate this notice" and

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[3]15 U.S.C.A. §1602(a) & 1604(a).

[4]*See* Regulation Z, Forms, 12 C.F.R. Appendix H, forms H-8 and H-9.

executed the loan contract to which the notice referred; and (2) she had not cancelled the contract. The one copy of the Notice that Ms. Merriman concedes she was given, on the other hand, contains no signatures and neither designated spot has been checked.

Ms. Merriman filed a Chapter 13 bankruptcy petition in October 2001. About a month later, her attorney sent Beneficial a notice on her behalf that she was exercising her right to rescind the transaction. Beneficial did not consider Ms. Merriman's rescission to be effective, and took no action as a result of the notice.

## ISSUES

1. Did Ms. Merriman receive two copies of the Notice as required by Regulation Z §226.23(b)(1)? If she received only one copy, did that shortcoming extend the duration of her right to rescind the transaction under TILA §1635 to three years, instead of the three-day period that normally applies?

2. Did Beneficial's form Notice satisfy the requirements of the TILA and Regulation Z to adequately inform Ms. Merriman of her right to rescind the transaction, even though neither of the designated spots were marked to show which of the alternative paragraphs applied to her transaction?

3. When a consumer-borrower properly exercises the right to rescind a home mortgage transaction, what authority does the Court have to condition or modify the consequences of the rescission that are specified in TILA §1635 and Regulation Z §226.23?

## DISCUSSION AND CONCLUSIONS

### Part I. Applicable Law

### A. Background of the TILA

Some background knowledge about the TILA is necessary to properly evaluate claims made under it. Congress enacted the TILA to regulate the disclosure of the terms of consumer credit transactions in order "to aid unsophisticated consumers and to prevent creditors from misleading consumers as to the actual cost of financing."[5] Disclosure allows consumers to compare different financing options and their costs.[6] To encourage compliance, TILA violations are measured by a strict liability standard, so even minor or technical violations impose liability on the creditor.[7] The consumer-borrower can prevail in a TILA suit without showing that he or she suffered any actual damage as a result of the creditor's violation of the TILA.[8]

The Fed has promulgated extensive regulations implementing the TILA,[9] all of which it calls "Regulation Z."[10] When the agency charged with enforcing a statute has promulgated a regulation that adopts a permissible construction of the statute, the courts must defer to that interpretation and not impose their own.[11] Furthermore, the Supreme Court has indicated this requirement is especially strong

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[5]*Morris v. Lomas & Nettleton Co.*, 708 F.Supp. 1198, 1203 (D.Kan. 1989) (citing *Mourning v. Family Publ'ns Serv., Inc.*, 411 U.S. 356, 363-69 (1973)).

[6]15 U.S.C.A. §1601(a).

[7]*See, e.g., Mars v. Spartanburg Chrysler Plymouth, Inc.*, 713 F.2d 65, 67 (4th Cir. 1983) ("To insure that the consumer is protected, as Congress envisioned, requires that the provisions of [the TILA and Regulation Z] be absolutely complied with and strictly enforced").

[8]*Herrera v. First Northern Savings and Loan Ass'n*, 805 F.2d 896, 900 (10th Cir. 1986).

[9]12 C.F.R. Part 226 (2003).

[10]*See* 12 C.F.R. §226.1(a) (2003).

[11]*Chevron U.S.A., Inc., v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-44 (1984).

in the context of the TILA and Regulation Z, where even official staff interpretations of the statute and regulation should control unless shown to be irrational.[12]

**B. Relevant provisions of the TILA**

Both these proceedings involve non-purchase-money loans[13] secured by consumer-borrowers' homes (their "principal dwellings"). In such transactions, the borrowers have a right to rescind that is established by TILA §1635. It provides in pertinent part:

> **(a) Disclosure of obligor's right to rescind**
> Except as otherwise provided in this section, in the case of any consumer credit transaction . . . in which a security interest . . . is or will be retained or acquired in any property which is used as the principal dwelling of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so. The creditor shall clearly and conspicuously disclose, in accordance with regulations of the Board, to any obligor in a transaction subject to this section the rights of the obligor under this section. The creditor shall also provide, in accordance with regulations of the Board, appropriate forms for the obligor to exercise his right to rescind any transaction subject to this section.
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> **(b) Return of money or property following rescission**
> When an obligor exercises his right to rescind under subsection (a) of this section, he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission. Within 20 days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, downpayment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under

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[12]*Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 559-70 (1980); *see also Anderson Brothers Ford v. Valencia*, 452 U.S. 205, 219 (1981) (citing *Milhollin*, Court indicated that absent "obvious repugnance" to statute, Fed's regulation implementing TILA and interpretation of that regulation should be accepted by courts).

[13]*See* 15 U.S.C.A. §1635(e)(1) and §1602(2) (exempting from §1635 liens against consumer-borrowers' homes that secure the financing of the acquisition or initial construction of the homes).

the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable, or inequitable, the obligor shall tender its reasonable value. Tender shall be made at the location of the property or at the residence of the obligor, at the option of the obligor. If the creditor does not take possession of the property within 20 days after tender by the obligor, ownership of the property vests in the obligor without obligation on his part to pay for it. The procedures prescribed by this subsection shall apply except when otherwise ordered by a court.

**(c) Rebuttable presumption of delivery of required disclosures**

Notwithstanding any rule of evidence, written acknowledgment of receipt of any disclosures required under this subchapter by a person to whom information, forms, and a statement is required to be given pursuant to this section does no more than create a rebuttable presumption of delivery thereof."[14]

So long as the creditor has not given the borrower the information, forms, and statement containing material disclosures required by §1635, the borrower's right to rescind will last for three years from the consummation of the transaction, with certain exceptions that do not apply in these cases.[15] Subsection (h) of §1635 provides:

**(h) Limitation on rescission**

An obligor shall have no rescission rights arising solely from the form of written notice used by the creditor to inform the obligor of the rights of the obligor under this section, if the creditor provided the obligor the *appropriate* form of written notice published and adopted by the Board, or a comparable written notice of the rights of the obligor, that was *properly* completed by the creditor, and otherwise complied with all other requirements of this section regarding notice.[16]

In 1995, Congress imposed a four-and-a-half month moratorium on courts certifying any class in any action under TILA §§1601 to 1677 based on, among other things, a creditor's alleged failure "to

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[14] 15 U.S.C.A. §§1635(a), (b), & (c).

[15] *See* TILA §1635(f), 15 U.S.C.A. §1635(f).

[16] 15 U.S.C.A. §1635(h) (emphasis added).

provide proper notice of rescission rights under section 1635(a) of this title due to the selection by the creditor of the incorrect form from among the model forms prescribed by the [Fed] or from among forms based on such model forms."[17] This shows Congress was aware that it was at least possible for a court to conclude that a creditor's selection of the wrong notice form violated §1635(a), but did not choose to declare that such an error was not a violation of the TILA, or otherwise amend the TILA to excuse such errors for an individual consumer's lawsuit.

**B. Relevant provisions of Regulation Z**

As indicated, the Fed has enacted a group of regulations, Regulation Z, to implement the TILA. The regulations are found at 12 C.F.R. Part 226. Various provisions in Regulation Z were amended in 2001 to permit electronic delivery of disclosures, notices, and so forth[18]; one aspect of those amendments has some impact, as noted below, on the Court's thinking in these proceedings but otherwise, the changes did not affect any of the parties' rights here.

Section 226.23[19] of Regulation Z implements the right to rescind a home mortgage transaction, as granted by TILA §1635. The following portions of §226.23 are relevant here:

> (a) *Consumer's right to rescind.* (1) In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction. . . .
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> . . . .
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> (4) When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.

[17] TILA §1640(i)(1)(B)(iii), 15 U.S.C.A. §1640(i)(1)(B)(iii).

[18] *See* 66 Fed. Reg. 17329, 17338-39 (March 30, 2001).

[19] 12 C.F.R. §226.23 (2003).

> (b)(1) *Notice of right to rescind.* In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered by electronic communication as provided in section 226.36(b)). The notice shall be on a separate document that identifies the transaction and shall clearly and conspicuously disclose the following:
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> . . . .
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> (iv) The effects of rescission, as described in paragraph (d) of this section.
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> (2) *Proper form of notice.* To satisfy the disclosure requirements of paragraph (b)(1) of this section, the creditor shall provide the appropriate model form in Appendix H of this part or a substantially similar notice.
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> . . . .
>
> (d) *Effects of rescission.* (1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge.
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> (2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.
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> (3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.
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> (4) The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order.[20]

The model form notices referred to in §226.23(b)(2) are Forms H-8 and H-9 in Appendix H to Regulation Z. Form H-8, the New Loan Form, is officially called "Rescission Model Form (General)," and applies to a loan from a creditor with no prior lien on the borrower's home. Form H-9, the Refinancing Form, is officially called "Rescission Model Form (Refinancing with Original Creditor)," and applies when a creditor that has a prior lien on the borrower's home extends additional credit that

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[20] 12 C.F.R. §226.23(a), (b), & (d) (2003).

is also secured by the home.

The New Loan Form is attached to this opinion as Appendix 1, and the Refinancing Form as Appendix 2. A reasonably accurate reproduction of Beneficial's Notice, showing its type size and styles, formatting, and so forth, is attached as Appendix 3.

**Part II. Resolution of Issues in These Proceedings**

**1. Effect of One Copy of Notice**

Although the parties have raised an issue of fact on the question whether Ms. Merriman received two copies of the Notice or just one, the Court concludes a resolution of that question is not necessary. The only apparent reason why Regulation Z required Beneficial to give Ms. Merriman two copies of the Notice is so she could have sent one to Beneficial if she decided to rescind the transaction, and still had the other for her own records. This view is supported by the 2001 amendments to Regulation Z that allow a creditor sending notice to the borrower electronically to send only one copy.[21] Unlike a physical copy, an electronic copy of the notice should remain on the borrower's computer (or other electronic system) even if the borrower sends a copy to the creditor in order to rescind the transaction, making a duplicate electronic copy superfluous.

But assuming that Beneficial's Notice was otherwise sufficient, the second physical copy of the Notice was not actually necessary to inform Ms. Merriman of her right to rescind. So long as she had one copy of the Notice, she could have returned it in order to cancel the transaction, and in these days of cheap photocopying, she could easily have made another copy to keep for her own records. In fact,

[21]*See* 66 Fed. Reg. at 17338 (amending 12 C.F.R. §226.23(b)(1)).

the Notice itself told her to keep one copy of it. Other courts have concluded that the failure to supply an additional copy of a valid notice of rescission does not extend the borrower's right to rescind the transaction.[22] While Regulation Z's requirement that two copies be provided to the borrower is probably not irrational, the Court believes it would be irrational to allow the borrower to have three years, rather than three days, to rescind the transaction just because he or she did not receive the extra copy of the notice of the right to rescind.

**2. Sufficiency of Notice Beneficial Gave to Ms. Merriman**

As indicated, Regulation Z §226.23(b)(2) provides that Beneficial could have satisfied the requirement that it give Ms. Merriman notice of her right to rescind the transaction if it had simply used the correct model form, the New Loan Form (H-8) or the Refinancing Form (H-9). This implements TILA §1604(b), which directs the Fed to publish model forms and provides that creditors are deemed to have complied with non-numerical TILA disclosure requirements if they use the appropriate model form.[23] TILA §1604(b) also provides that a creditor shall be deemed to have complied if it: "(2) uses any such model form . . . and changes it by (A) deleting any information which is not required by this subchapter, or (B) rearranging the format, if in making such deletion or rearranging the format, the creditor . . . does not affect the substance, clarity, or meaningful sequence of the disclosure."[24] The

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[22]*See Contimortgage Corp. v. Delawder*, 2001 WL 884085 (Ohio App. July 30, 2001); *but see Davison v. Bank One Home Loan Servs.*, 2003 WL 124542 at *5-6 (D.Kan. Jan. 13, 2003) (Vratil, J.) (denying summary judgment on creditor's claim that failure to give required number of copies did not constitute failure to make any material disclosure that would extend duration of borrowers' right to rescind).

[23]15 U.S.C.A. §1604(b).

[24]15 U.S.C.A. §1604(b)(2)(A) & (B).

Court must determine whether Beneficial's Notice constituted "a substantially similar notice,"[25] and §1604(b)(2) aids the Court's analysis by indicating some of what is required for a creditor's non-model-form notice to be "substantially similar."

The Court does not believe that Beneficial's Notice deleted any information contained in the model forms, but it definitely rearranged the format. It also incorporated certain language from each model form in an effort to make the single form cover both types of transaction. The Court must now carefully compare the Notice with the model forms. First, the Court notes that the model forms are more concise and therefore, express the right to rescind more clearly.[26] The language in Beneficial's Notice closely follows that in the model forms, but repeats much of its first paragraph in each of the alternative paragraphs whose applicability is to be indicated by marking the designated spot. The model forms use the same type size and style throughout except for the headings and the phrase "I WISH TO CANCEL," while the Notice appears to employ at least two type sizes and styles in a way that calls more attention to some portions, thus de-emphasizing others. The Notice also adds the portion the borrower is to sign to certify the receipt of the Notice "in duplicate." This creates a bit of possible confusion by making the borrower sign again if he or she decides to rescind the transaction. It

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[25]12 C.F.R. §226.23(b)(2).

[26]Ms. Merriman's counsel says that the Refinancing Form (form H-9) contains the following: "we acquired a mortgage on your home under the original transaction and will retain that mortgage in the new transaction." Memorandum in Support of Plaintiff's Motion for Summary Judgment, Adv. No. 01-7142, pleading no. 17 at p. 18. The Court cannot find this language in the Refinancing Form, which has remained unchanged since at least January 1998. *See* 12 C.F.R. Part 226, App. H at 338 (listing history of enactment and amendments to App. H). The App. H amendment published at 66 Fed. Reg. 65618 (Dec. 20, 2001), is the only amendment since January 1998, and it just added form H-16. Consequently, the Court has ignored Ms. Merriman's reliance on the quoted language.

would also be clearer if it indicated the receipt of "two copies of the Notice" instead of the "Notice in duplicate." Most significantly, of course, the Notice includes the alternative paragraphs, making necessary the spots to be marked. Because Beneficial failed to mark either spot on the Notice it gave to Ms. Merriman, it placed on her the burden of determining which paragraph might apply to her. In her case, the potential confusion caused by the failure to mark the spot was even greater than it would have been for borrowers like the Ramirezes because she did have an existing loan with Beneficial that was refinanced in this transaction, although the new loan paragraph actually applied to her because the existing loan was not secured by her home. While Beneficial's Notice might have been sufficient if the applicable paragraph had been marked, the Court concludes the unmarked Notice was definitely not sufficient. Therefore, Ms. Merriman was entitled to an extended rescission period under TILA §1635(a).

**3. Effect of Rescission**

Because both the Ramirezes and Ms. Merriman had the extended time to exercise their right to rescind their home mortgage transactions and properly did so within that extended time, the Court must determine the effect of their rescissions. The Court previously explained in *Quenzer v. Advanta Mortgage Corporation*[27] ("*Quenzer I*") its view that when a borrower timely and properly rescinds a home mortgage transaction, TILA §1635(a) and (b), as implemented by Regulation Z §226.23(d), make the lender's mortgage void and excuse the borrower from any obligation to pay interest on the loan, and that courts are not authorized to alter either of those effects of the rescission. Although

[27]266 B.R. 760 (Bankr. D. Kan. 2001).

*Quenzer I*, along with a related decision in the Quenzer case ("*Quenzer II*"[28]), has been reversed by Judge Crow ("*Quenzer III*"[29]), Judge Van Bebber has explained that because the district judges in the District of Kansas are not bound by *stare decisis* to follow one another's decisions, the bankruptcy courts are not bound to do so either.[30] Consequently, while *Quenzer III* establishes the law of the case for the Quenzer adversary proceeding from which it arose, its effect in these cases is limited to its persuasiveness. In several respects, the Court is not convinced by the reasoning in *Quenzer III*.

Most, if not all, of the decisions declining to enforce §1635's voiding of the creditor's mortgage and barring of the creditor's collection of interest, like *Quenzer III*, involve rescissions made long after the normal three-day period called for by the TILA and Regulation Z.[31] That circumstance clearly alters the apparent equities that will face a court considering rescission questions. However, the ordinary situation envisioned by the statute and regulation is one where the creditor has given the TILA-mandated disclosures and notices, and the borrower has decided to rescind during the three-day period, the only rescission period available when the creditor has made no errors under the TILA and Regulation Z. In such a situation, the (careful) lender would not have distributed any money to the

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[28]274 B.R. 899 (Bankr. D. Kan. 2001).

[29]*Quenzer v. Advanta Mortgage Corp. USA (In re Quenzer)*, 288 B.R. 884 (D.Kan. 2003).

[30]*In re KAR Development Associates, L.P.*, 180 B.R. 629, 640 (D. Kan. 1995); *see also Campbell By and Through Jackson v. Hoffman*, 151 F.R.D. 682, 684 n. 1 (D. Kan. 1993) (Rogers, J.) (recognizing that district judges within a district are not bound by one another's decisions). Both these decisions rely on *Threadgill v. Armstrong World Industries, Inc.*, 928 F.2d 1366, 1371 and n.7 (3d Cir. 1991) as authority for their conclusions.

[31]*See, e.g., Williams v. Homestake Mortgage Co.*, 968 F.2d 1137, 1138 (11th Cir. 1992); *Apaydin v. Citibank Federal Savings Bank (In re Apaydin)*, 201 B.R. 716, 718 (Bankr. E.D. Pa. 1996); *Lynch v. GMAC Mortgage Corp. (In re Lynch)*, 170 B.R. 26, 27-28 (Bankr. D.N.H. 1994).

borrower or anyone else designated to receive any of the loan proceeds. The application of §1635 and §226.23(d) would be clear. Having received the borrower's notice of rescission, the lender would have to undo any steps it had taken to make its mortgage publicly known and return to the borrower any fees or closing costs paid up front in the transaction, but it would also not be obliged to distribute the loan proceeds.[32] The borrower would usually not have any money to return to the lender because he or she would not have received any yet, but if any had been distributed, he or she would be obliged to return it to the lender once the lender returned the fees, closing costs, and any prepaid interest. The promise of the notice of rescission form given to the borrower would be fulfilled in this situation, and no court would be likely to allow the lender to retain its mortgage or any interest the borrower might have paid. If this is the clear meaning of the statute and regulation in that situation, how can the meaning change just because the lender has gone forward with the transaction despite its own violation of §1635's notice requirement? If the lender distributes the loan proceeds before the rescission period has expired, its risk of loss is certainly increased, but complying with the notice requirement does not appear to be particularly difficult.

*Quenzer III* relied heavily on the Tenth Circuit's decision in *Rachbach v. Cogswell*.[33] When *Rachbach* was decided, neither §1635 nor the version of Regulation Z then in effect said anything about a court's authority to modify the rescission process.[34] Because *Rachbach* ruled that the lower

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[32] *See Morris v. Lomas and Nettleton Co.*, 708 F.Supp. 1198, 1205 (D. Kan. 1989) (noting that creditor may not disburse funds during three-day rescission period and must satisfy itself that consumer has not rescinded before completing transaction).

[33] 847 F.2d 502 (10th Cir. 1976); *see Quenzer III*, 288 B.R. at 887-89.

[34] *See Quenzer I*, 266 B.R. at 766.

court had not abused its discretion by refusing to excuse the borrower from interest charges even though the first sentence of §1635(b) said at the time (as it does now) that a rescinding borrower "is not liable for any finance or other charge," *Quenzer III* ruled that courts can still rely on their inherent authority to do equity to condition the voiding of the creditor's mortgage on the borrower's tender back of the money or property received in the transaction.[35] As this Court pointed out in *Quenzer I*,[36] though, in 1980, a few years after *Rachbach* was decided, Congress amended §1635 by adding the last sentence to subsection (b), expressly giving the courts authority to change at least part of what happens when the debtor rescinds,[37] and a short time later, in 1981, the Fed completely revised Regulation Z, adopting the current structure of §226.23(d), which specifies that the courts can modify only the reciprocal obligations to return money and property that arise after the mortgage has become void and the borrower's obligation to pay any interest has been eliminated.[38] In this Court's view, it is one thing to say that the courts can exercise their equitable powers to alter a statutory and regulatory remedy when the statute and regulation express no limits on the courts' powers and use terms ("rescind" and "rescission") that can be used to refer to a traditional equitable remedy, but quite another to say that the courts can ignore limits on their powers that are explicitly specified in a statute and

[35]288 B.R. at 887-88.

[36]266 B.R. at 766-67.

[37]*See* Truth in Lending Simplification and Reform Act, Title VI of Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, §612(a)(4), *reprinted in* 1980 U.S.C.C.A.N. (94 Stat.) 132, 175.

[38]*See* Truth in Lending, Revised Regulation Z, 46 Fed. Reg. 20848, 20905 (Apr. 7, 1981) (codified at 12 C.F.R. §226.23(d)).

regulation.

The Court is similarly not convinced by *Quenzer III*'s statement that Regulation Z §226.23(d) "does not expressly include the 'automatic' voiding of the security interest upon rescission among those procedures it specifically authorizes a court to modify."[39] This would seem to suggest that the Fed might simply have overlooked the voiding of the security interest or have made some sort of clerical error by omitting the voiding as a procedure a court can modify. The structure of §226.23(d) strongly refutes such a suggestion. It contains four numbered subsections. Subsections (1), (2), and (3) each state some effect of a borrower's rescission of a transaction, and subsection (4) states that courts can modify the effects under subsections (2) and (3). If the Fed had intended for courts to be able to modify the effects stated in subsection (1), then subsection (4) would either expressly include it or simply say that courts can modify any of the effects of the borrower's rescission. The Court notes that *Quenzer III* did not suggest that the Fed's interpretation of §1635 in Regulation Z was irrational, and therefore not controlling.[40]

But *Quenzer III* is not alone in concluding—without declaring that Regulation Z is irrational—that courts can condition the voiding of the mortgage on the borrower's repayment obligations. In *Williams v. Homestake Mortgage Co.*, the Eleventh Circuit noted the clear meaning of §226.23(d) and the court's obligation to defer to the Fed's interpretation of the TILA, agreed that reading the regulation to bar courts from altering the immediate voiding of the security interest was

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[39]288 B.R. at 889.

[40]*See Ford Motor Credit v. Milhollin*, 444 U.S. at 559-70 (Regulation Z's interpretation of TILA is controlling unless shown to be irrational).

"technically correct," and yet concluded that the legislative history of the 1980 amendments to the TILA established that courts can override the voiding of the security interest.[41] Nowhere in the decision did the circuit expressly declare that it was holding §226.23(d) to be irrational.

The ultimate driving force behind the *Quenzer III* decision was expressed in two sentences: "This court cannot accept the proposition that strict enforcement of TILA justifies rendering a debt in the amount at issue here [$48,000 or more] unpaid and completely unsecured, given the passage of time and other circumstances present. Even though the defendant violated TILA, automatically relegating its entire claim to unsecured status under these circumstances would be completely inequitable and would exact a penalty entirely disproportionate to its offense."[42] While the sentiment is understandable, this Court believes that courts are not authorized to substitute their sense of equity for the mandates of the TILA and Regulation Z. The Supreme Court's decisions in *Ford Motor Credit v. Milhollin*[43] and *Anderson Brothers Ford v. Valencia*[44] make clear that courts must defer to the Fed's interpretation of the TILA.

As indicated earlier, as recently as 1995, Congress recognized that at least some courts were allowing extended rescission periods based on violations of the TILA which it characterized as being minor or technical. The class action moratorium imposed in 1995 was apparently inspired by the

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[41]968 F.2d 1137, 1142 (11th Cir. 1992).

[42]288 B.R. at 889.

[43]*See* 444 U.S. at 562-70 (when the TILA and Regulation Z are silent on an issue, courts cannot even substitute their views for views expressed by the staff of the Fed).

[44]452 U.S. at 211-23 (even Fed staff interpretation not yet adopted by Federal Reserve Board was entitled to deference from courts).

aftermath of the decision in *Rodash v. AIB Mortgage Co*.[45] In *Rodash*, the Eleventh Circuit held that a borrower's right to rescind a $102,000 loan was extended beyond the usual three-day period because at the same time as she signed all the other loan documents, the lender had presented her with a pre-printed election not to cancel the loan.[46] The court went on to hold that the lender had also violated the TILA by including a $22 Federal Express charge and a $204 state intangibles tax in the "amount financed" disclosure rather than the "finance charge."[47] Apparently, the decision was soon followed by a number of class action TILA suits.[48] In support of the class action moratorium, one Senator mentioned *Rodash* and then said:

> The Truth in Lending Act is a complex law with almost no room for forgiveness if an honest technical error is made by the lender. Under truth in lending, for a mistake as little as $11 in how a charge is disclosed, the lender could be forced to reimburse all fees and costs to the borrower, including all interest paid for up to 3 years. In addition, the lender must release the mortgage lien, leaving the lender with an unsecured loan. These laws encourage cookie-cutter lending in order to avoid mistakes. Consumers are then hurt by higher rates and less lending.

Despite this concern about the impact of *Rodash* and the recognition that rescission can force the creditor to release its mortgage lien and reimburse all interest the borrower has paid, Congress has not acted to change this aspect of TILA §1635 and Regulation Z §226.23.

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[45]16 F.3d 1142 (11th Cir. 1994).

[46]16 F.3d at 1145-47.

[47]16 F.3d at 1147-49.

[48]*See* 141 Cong.Rec. S5614 at S5614 (daily ed. April 24, 1995) (statement of Sen. Mack about H.R. 1380, Truth in Lending Class Action Relief Act of 1995, enacted as 15 U.S.C.A. §1640(i)), *available at* 1995 WL 236489; *see also* 141 Cong. Rec. H9513, at H9514 (daily ed. September 27, 1995) (statement of Rep. Leach about H.R. 2399, Truth in Lending Act Amendments of 1995, enacted as Pub. L. 104-29), *available at* 1995 WL 568966.

Despite the Court's disagreement with much of the reasoning in *Quenzer III*, the Court nevertheless feels constrained to follow its result for two main reasons. First, it appears that a majority of courts have been refusing to enforce the automatic voiding of the creditor's mortgage lien despite the mandate of TILA §1635(a) and (b), and Regulation Z §226.23(d). Second, the parties now before the Court have indicated their desire to pursue any intermediate appellate ruling to the Tenth Circuit. If the Court were to follow its decisions in *Quenzer I* and *II*, and the Bankruptcy Appellate Panel or district judge to whom the appeal in these cases is assigned chose instead to follow the decision in *Quenzer III*, and reverse and remand the proceedings, that appellate ruling would probably be interlocutory and not appealable to the Tenth Circuit as of right, but only with the Circuit's permission. This would likely mean a further decision by the undersigned's successor and a further appeal to the B.A.P. or district court would be necessary before the Circuit would address the merits of these disputes.

Consequently, the Court will allow the creditor's mortgage liens to remain intact in both these cases, but will alter the amounts secured by those liens as discussed in the next section.

**Part III**

**A. The Ramirezes**

Although Household has conceded that the Ramirezes are entitled to rescind their home mortgage transaction, it has not responded to their attorney's calculation of the amounts involved in the parties' reciprocal payment obligations under TILA §1635(b) and Regulation Z §226.23(d)(2) and (3). The Court therefore assumes that the figures the Ramirezes' attorney has used in his brief are the correct figures for the specified items, and will use those amounts in making its own calculations. Although Household's mortgage lien against the Ramirezes' home will not be declared void, the Court believes the fact that the Ramirezes are in a Chapter 13 bankruptcy case still justifies altering the procedures specified in the TILA and Regulation Z by offsetting the parties' obligations, as the Court did in *Quenzer II*.

This means that the closing costs and fees Household charged Mr. Ramirez in the transaction, $17,308.56,[49] plus all amounts paid on the loan since the closing, $15,243.52,[50]—a total of $32,552.08—must be subtracted from the principal amount of the loan, $113,061.94,[51] leaving a balance of $80,509.86 as the amount of Mr. Ramirez's debt to Household.

The Ramirezes also claim they are entitled to recover statutory penalties from Household because it failed to make the required disclosures to Mrs. Ramirez and failed to proceed with its obligations under §1635(b) and §226.23(d) within twenty days after it received their notice of rescission. TILA §1640 provides in pertinent part:

**(a) Individual or class action for damages; amount of award; factors determining amount of award**

> Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this part, including any requirement under section 1635 of this title, or part D or E of this subchapter with respect to any person is liable to such person in an amount equal to the sum of—
>
> (1) any actual damage sustained by such person as a result of the failure; [and]
>
> (2)(A) . . . (iii) in the case of an individual action relating to a credit transaction not under an open end credit plan that is secured by real property or a dwelling, not less than $200 or greater than $2,000; . . .

The Ramirezes claim no actual damages here, and the Court agrees that Household is liable for its

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[49]Disclosed on Exhibit A to the Ramirezes' motion.

[50]Shown on Exhibit H to the Ramirezes' motion.

[51]Shown on Exhibit A to the Ramirezes' motion.

disclosure violations and failure to respond within twenty days to their notice of rescission. However, in light of the substantial reduction in Household's claim as a result of the offsets noted above, the Court will impose only the minimum penalty for each violation, for a total penalty of $400. This means that Household's secured claim against Mr. Ramirez totals $80,109.86.

The Ramirezes are also entitled to recover costs and attorney fees under TILA §1640(a)(3). Their attorney should submit an application for his fees on or before June 30, 2003.

**B. Ms. Merriman**

Like Household, Beneficial has not responded to Ms. Merriman's attorney's calculation of the amounts involved in the parties' reciprocal payment obligations under TILA §1635(b) and Regulation Z §226.23(d)(2) and (3). The Court therefore assumes that the figures Ms. Merriman's attorney has used in his brief are the correct figures for the specified items, and will use those amounts in making its own calculations. Although Beneficial's mortgage lien against Ms. Merriman's home will not be declared void, the Court believes the fact that Ms. Merriman is in a Chapter 13 bankruptcy case still justifies altering the procedures specified in the TILA and Regulation Z by offsetting the parties' obligations, as the Court did in *Quenzer II*.

This means that the closing costs and fees Beneficial charged Ms. Merriman in the transaction, $5,206.09,[52] plus all amounts paid on the loan since the closing, $3,981.84,[53]—a total of $9,187.93—must be subtracted from the principal amount of the loan, $30,359.45,[54] leaving a balance

[52]Disclosed on Exhibit A to Ms. Merriman's complaint.

[53]Shown on Exhibit J to Ms. Merriman's motion.

[54]Shown on Exhibit A to Ms. Merriman's complaint.

of $21,171.52 as the amount owed to Beneficial. Ms. Merriman also seeks statutory penalties under TILA §1640(a)(2)(A)(iii) for Beneficial's failure to give her adequate notice of her right to rescind the transaction and its failure to respond within twenty days to her notice of rescission. Once again, in light of the substantial reduction of Beneficial's claim as a result of the offsets noted above, the Court will impose the minimum penalty for these violations, or a total of $400. This reduces Beneficial's claim against Ms. Merriman to $20,771.52.

Ms. Merriman is also entitled to recover costs and attorney fees under TILA §1640(a)(3). Her attorney should submit an application for his fees on or before June 30, 2003.

Judgments based on this order will be entered on separate documents as required by Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58.

Dated at Topeka, Kansas, this ____ day of May, 2003.

________________________________

JAMES A. PUSATERI
BANKRUPTCY JUDGE

H-8—Rescission Model Form (General)

NOTICE OF RIGHT TO CANCEL

**Your Right to Cancel**

You are entering into a transaction that will result in a [mortgage/lien/security interest] [on/in] your home. You have a legal right under federal law to cancel this transaction, without cost, within three business days from whichever of the following events occurs last:

(1) the date of the transaction, which is __________; or
(2) the date you received your Truth in Lending disclosures; or
(3) the date you received this notice of your right to cancel.

If you cancel the transaction, the [mortgage/lien/security interest] is also cancelled. Within 20 calendar days after we receive your notice, we must take the steps necessary to reflect the fact that the [mortgage/lien/security interest] [on/in] your home has been cancelled, and we must return to you any money or property you have given to us or to anyone else in connection with this transaction.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**How to Cancel**

If you decide to cancel this transaction, you may do so by notifying us in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of

(date)

(or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL

______________________ __________

Consumer's Signature Date

H-9—RESCISSION MODEL FORM (REFINANCING WITH ORIGINAL CREDITOR)

## NOTICE OF RIGHT TO CANCEL

### Your Right to Cancel

You are entering into a new transaction to increase the amount of credit previously provided to you. Your home is the security for this new transaction. You have a legal right under federal law to cancel this new transaction, without cost, within three business days from whichever of the following events occurs last:

(1) the date of this new transaction, which is __________; or
(2) the date you received your new Truth in Lending disclosures; or
(3) the date you received this notice of your right to cancel.

If you cancel this new transaction, it will not affect any amount that you presently owe. Your home is the security for that amount. Within 20 calendar days after we receive your notice of cancellation of this new transaction, we must take the steps necessary to reflect the fact that your home does not secure the increase of credit. We must also return any money you have given to us or anyone else in connection with this new transaction.

You may keep any money we have given you in this new transaction until we have done the things mentioned above, but you must then offer to return the money at the address below.

If we do not take possession of the money within 20 calendar days of your offer, you may keep it without further obligation.

### HOW TO CANCEL

If you decide to cancel this new transaction, you may do so by notifying us in writing, at

______________________________________

(Creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of

______________________________________

(Date) ______________________________

(or midnight of the third business day following the latest of the three events listed above).

If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL

______________________________________

Consumer's Signature

______________________________________

Date

**NOTICE OF RIGHT TO CANCEL**

**BORROWER'S NAME AND ADDRESS:** **LOAN NO:** 454401-00-173663

MERRIMAN, PAT
[STREET ADDRESS]
[P.O. BOX]
[CITY, KS ZIP]

**YOUR RIGHT TO CANCEL**

You are entering into a new transaction and you have agreed to give us a mortgage, lien or security interest on your home in this transaction. You have a legal right under federal law to cancel this transaction and the new mortgage, lien or security interest on your home, without cost, within three business days from whichever of the following events occurs last:

(1) the date of this transaction, which is 08/21/00 or such later date you sign you loan documents; or

(2) the date you receive your Truth-in-Lending disclosures for this transaction; or

(3) the date you received this notice of your right to cancel.

(__) **New Loan:** *You are entering into a transaction that will result in a mortgage, lien or security interest on your home. You have a legal right under federal law to cancel this transaction as stated above. If you cancel this transaction, the mortgage, lien or security interest is also canceled. Within 20 calendar days after we receive your notice, we must take the steps necessary to reflect the fact that the mortgage, lien or security interest on your home has been canceled and we must return to you any money or property you have given to us or to anyone else in connection with this transaction.*

(__) **Refinancing Existing Loan:** *You are entering into a new transaction to increase the amount of credit previously provided to you by us. Your home is the security for this new transaction. You have a legal right under federal law to cancel this transaction as stated above. If you cancel this new transaction, it will not affect any amount that you presently owe. Your home is already the security for that amount. Within 20 calendar days after we receive your notice of cancellation of this new transaction, we must take the steps necessary to reflect the fact that your home does not secure the increase in credit. We must also return any money you have given to us or anyone else in connection with this new transaction.*

If you cancel this transaction, you may keep any money or property we have given you in this transaction until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at you home or at the location of the property. Money must be returned to the address below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**HOW TO CANCEL**

If you decide to cancel this transaction, you may do so by notifying us in writing, at

BENEFICIAL MORTGAGE CO OF KANSAS, INC.
555 POYNTZ AVE
SUITE 110
MANHATTAN, KS 66502

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram you must sent the notice no later than midnight of 08/24/00 (or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL

____________________ ______________________

Consumer's signature Date

I certify that I received this Notice in duplicate.

______________________________________ (SEAL)

______________________________________ (SEAL) ______________________________________(SEAL)